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REGIONAL AND POLITICAL ANALYSIS

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This publication is prepared for regional specialists in the Washington community by the Latin America Division, Office of Regional and Political Analysis, with occasional contributions from other offices within the Directorate of Intelligence and from other agencies within the Intelligence Community. Comments and queries are welcome. They should be directed to the authors of the individual articles.

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Argentina: Improved Foreign Financial Situation

The military junta that took over last year has brought Argentina back from the brink of international bankruptcy to a state of comfortable solvency. International obligations are being met, and reserves have reached an all-time high. The government must now induce industry to exploit the favorable foreign balance by importing more of the materials needed for raising domestic production. Economic prospects for the remainder of 1977 are good even though the government still faces serious domestic problems--inflation, a large budget deficit, and lagging industrial production. Its handling of these problems over the next year or so will help determine whether it remains in power long enough to consolidate its gains.

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Inherited Problems

When the military ousted the Peronist government in March 1976, the economy was approaching disaster. The trade balance had registered $0.5 billion deficit in 1975--compared with a $1.3 billion surplus two years earlier, when a good grain harvest boosted exports, and an $800 million surplus in 1974. The 1975 drop resulted from a poor grain harvest, the loss of EC markets for meat, and an unrealistic exchange rate that made Argentine manufactures uncompetitive while encouraging importers to buy heavily abroad in anticipation of a major devaluation. Although the higher cost of oil imports also contributed to the trade deficit, oil costs are less significant for Argentina than for most oil-importing countries because domestic oil production covers 85 to 90 percent of requirements. In addition, poor debt planning had allowed a concentration of foreign debt payments to build up in 1976. Reserves were near the vanishing point.

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Domestic production was stagnant. Government policies had discouraged agricultural output, while manufacturers found themselves in a profit squeeze between rising costs and regulated prices. Inflation was spiraling upward so rapidly that, if left unchecked, the 1976 rate

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would have approached 1,000 percent. With a bloated bureaucracy and an inadequate revenue structure, the government deficit was rising rapidly, and the regime was increasingly covering expenditures by issuing more currency. For their part, workers were demanding and getting sizable wage increases in an effort to offset rising prices. Argentina's foreign credit rating was poor, and the Peronist government had not yet lined up funds to cover its foreign financial gap.* This gap had widened from a $0.5 billion in 1974 to $2 billion in 1975.

Argentina: Foreign Financial Gap

	1973	1974	1975	1976[1]	1977[2]
	Million US $				
Exports, f.o.b.	3,266	3,931	2,961	3,895	4,500
Imports, f.o.b.	1,983	3,160	3,431	2,652	3,500
Net services and transfers	-563	-644	-815	-632	-790
Current account balance	720	127	-1,285	611	210
Debt amortization	-573	-600	-800	-1,000	-1,000
Financial gap	**147**	**-473**	**-2,085**	**-389**	**-790**
Medium- and long-term capital inflows	594	723	NA	1,300	NA
Net short-term capital inflows	180	-301	NA	290	NA
Change in reserves	921	-51	-791	1,201	-300
External debt, yearend	4,672	4,873	4,695	5,189	4,679
	Percent				
Debt service ratio	20	17	30	29	25

[1] Preliminary.
[2] Projected.

*Financial gap *is defined as the current account deficit plus amortization of medium- and long-term debt; shifts in short-term capital are not included.*

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1976--The Bail Out

The new junta immediately focused on the need to stimulate exports, with emphasis on agricultural products. It reversed the previous policy of keeping agricultural prices low to benefit urban workers. Sharply increased prices for farm products, improved availability of credits, and abolition of the marketing monopoly of the state grain board led to a 10 percent increase in grain areas planted. Favorable weather during the growing and harvesting seasons then contributed to a bumper crop. Although world wheat prices dropped, aggressive marketing by private Argentine grain sales agencies--pushed by a shortage of facilities to store the record crop--accounted for a large share of the $900 million increase in total exports in 1976. This trend continued into 1977, when the remainder of the harvest was marketed.

Meat exports nearly doubled in 1976 compared with the depressed 1975 level, aided by more realistic exchange rates. With continual "microdevaluations" of the peso to offset inflation and the gradual elimination of the dual exchange rate, the government also succeeded in stimulating exports of nontraditional products by the end of the year. Imports dropped 23 percent in 1976 as inventories were drawn down and as demand was dampened by recession.

In addition to initiating the export promotion program, Economics Minister Martinez de Hoz launched a worldwide effort to obtain foreign loans. In personal approaches to banks and international financial institutions in the US, Canada, Western Europe, and Japan he succeeded in lining up nearly $1 billion in four- to five-year loans. Together with $300 million from the International Monetary Fund, these loans enabled Argentina to meet debt obligations and to improve the debt maturity profile.

By the end of 1976, debt payment coverage was assured. Moreover the trade balance had swung from a $500 million deficit in 1975 to a $1.2 billion surplus. The current account balance totaled $600 million, compared with a $1.3 billion deficit the year before. International reserves had trebled. Gains on the domestic front promised further improvement in the general economic climate and the restoration of foreign confidence in Argentina's financial soundness:

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--GDP, although down 2.9 percent for 1976 as a whole, was rising in the last quarter.

--The inflation rate was down from more than 400 percent (annual basis) in the first half 1976 to about 100 percent in the second half.

--The national budget deficit, which equaled 13.5 percent of GDP in the first half of 1976, was down to about half that level in the second half; for the year as a whole, 41 percent of expenditures were covered by revenues, compared with only 23 percent in 1975.

1977--Maintaining the Pace

The foreign financial situation has remained highly favorable so far. Exceptionally large grain shipments boosted exports to $1.8 billion in the first four months, double the level of imports. More than 85 percent of imports consisted of industrial inputs and capital goods, signaling an upturn in industrial output. To encourage this trend, the government has removed practically all restrictions on imports. If production picks up, imports should be considerably larger in the remainder of the year; exports will decline until the next harvest begins in November. The government's economic team projects the year's exports at $4.3 billion to $4.5 billion, the trade surplus at close to $1 billion, and the current account surplus at $200 million.

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The junta is continuing its program of incentives for agriculture and expects another large grain harvest in 1977-78. It is also counting on realistic exchange policies to boost exports of manufactured goods.

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Debt payments due in 1977 are close to the 1976 level of $1 billion and will require additional borrowing to cover. Although an improved credit rating will make loans easier to obtain, new borrowing is expected to total less than one third the 1976 level because of record foreign reserves. Argentina almost certainly will choose to reduce its external debt rather than accumulate additional reserves.

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Farther Down the Road

Longer range prospects for the Argentine economy are clouded by political uncertainties. If the present economic team remains in power and adheres to current policies, the economic recovery is likely to accelerate and the foreign financial situation should continue improving. In light of past Argentine experience, however, it cannot be assumed that this will happen.

The well-organized and traditionally influential labor sector has been a major factor forcing previous military governments to abandon promising economic reform programs. Much of the burden of the present economic readjustment has fallen on the working class, whose purchasing power--as the regime concedes--may have dropped by one third in the past year. Labor organizations have lost most of their political influence and lack a central rallying point since Juan Peron's death. If public opinion turns against the junta, however, labor elements could probably exert enough pressure to force the government to ease restrictions on wages and union activities. Continuation of the present economic program would then be impossible. If changes were made that favored urban labor at the expense of agriculture, the problems that characterized much of the last three decades would reappear.

Another possible development would be the ascendancy of a more hard-line group within the military that would replace the present gradualist, free enterprise approach with stricter controls. Although this policy might bring down inflation more rapidly, it could stifle the reviving manufacturing sector and cause extensive unemployment. Any change from the present government would probably have a generally destabilizing effect.

Foreign investors are wary because of past experience with Buenos Aires' vacillating economic policies and are waiting for more solid evidence of political stability before investing heavily. They are favorably impressed, however, with the junta's liberalization of foreign investment laws and with its efforts to settle outstanding disputes with several foreign firms. Increasing numbers of businessmen are visiting Argentina to study investment opportunities. Some foreign firms--especially oil companies--are increasing their exposure.

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The financial gap should decline moderately over the next few years, as annual debt payments diminish with better debt scheduling. The current account surplus may not increase substantially, since rising imports will probably limit trade surpluses. Agricultural exports--in which Argentina has a comparative advantage--should remain large; exports of manufacturers, especially autos and other transport equipment, probably will increase. Covering even a sizable financial gap should present no problem. [redacted] 3.5(c)

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